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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
	)	MM Docket No. 92-264
Implementation of Section 11 (c) of the Cable Television Consumer Protection and Competition Act of 1992	)	
	)	
Horizontal Ownership Limits	)	
	)	
Implementation of the Cable Television Consumer Protection and Competition Act of 1992	)	
	)	CS Docket No. 98-82
Review of the Commission's Cable Attribution Rules	)	
	)	

COMMENTS OF AMERITECH NEW MEDIA, INC.

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COMMENTS OF AMERITECH NEW MEDIA, INC.

Ameritech New Media, Inc. ("Ameritech")[1] respectfully submits these comments on some of the issues concerning the Commission's cable television horizontal ownership and ownership attribution rules raised in the Commission's notices of proposed rulemaking in above-captioned dockets.[2]

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[1] Ameritech New Media, Inc., which is a subsidiary of Ameritech Corp. began operation as a competitive cable operator in May 1996, currently has 78 franchises, serves 61 communities in the Chicago, Detroit, Cleveland and Columbus area markets, and is the largest cable overbuilder in the country.

[2] *Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal Ownership Limits*, MM Docket No. 92-264, Memorandum Opinion and Order on Reconsideration and Further Notice of Proposed Rulemaking, FCC 98-138 (rel. June 26, 1998) (*Horizontal Concentration NPRM*); *Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Review of the Commission's Cable Attribution Rules*, CS Docket No. 98-82, Notice of Proposed Rulemaking, FCC 98-112 (rel. June 26, 1998) (*Attribution NPRM*). Because many of the issues raised in these dockets, including those of particular concern to Ameritech, are closely inter-related, Ameritech is filing these comments in both dockets.

I. Introduction.

In these proceedings, the Commission seeks comment on a host of issues relating to its cable television horizontal ownership and ownership attribution rules.[3] Of particular concern to Ameritech, the Commission seeks comment on whether it should modify the current cable television horizontal ownership limits in light of evolving market conditions[4] and relax the cable television ownership attribution criteria.[5] Ameritech believes that the answer to both of these questions, at least under existing market conditions, is no.[6]

[3] In 1993, the Commission adopted rules implementing section 613 of the Communications Act, which directs the Commission to "prescribe rules and regulations establishing reasonable limits on the number of cable subscribers a person is authorized to reach through cable systems owned by such person, or in which such a person has an attributable interest" ("horizontal ownership rules"). 47 U.S.C. § 533(f)(1)(A). Those rules generally provide that "no person or entity shall be permitted to reach more than 30% of all homes passed nationwide through cable systems owned by such person or entity or in which such person or entity holds an attributable interest." 47 C.F.R. § 76.503. The Commission voluntarily stayed the effective date of the horizontal ownership rules pending final judicial resolution of the District Court decision in *Daniels Cablevision, Inc. v. United States*, 835 F.Supp. 1, 10 (D.D.C. 1993), *aff'd in part, rev'd in part, Time Warner Entertainment Co., L.P. v. FCC, 93 F.3d 957 (D.C. Cir.* 1996), which held section 613 unconstitutional. In 1994, Time Warner challenged the stayed rules in the D.C. Circuit, which, in 1996, consolidated Time Warner's challenge with the *Daniels* appeal, and held court proceedings in abeyance pending Commission reconsideration of the horizontal ownership rules. Less than two months ago, the Commission reaffirmed its horizontal ownership rules, maintaining the existing 30% horizontal ownership limit, and lifted the voluntary stay on enforcement of that limit.

The ownership attribution rules, which define what constitutes a cognizable interest that triggers application of various Commission rules (including, significantly, the horizontal ownership limits), are "intended to identify those relationships that confer on their holders a degree of influence or control over key business decisions, including budget, personnel, programming, and technology practices of cable entities, such that the holders should be subject to the Commission's regulations." *Attribution NPRM*, FCC 98-112 at para. 12. The rules are also used "to identify ownership or other relationships that could provide the entities involved with economic incentives to operate in conflict with the objectives of the particular cable regulation at issue." *Id.*

[4] *Horizontal Concentration NPRM*, FCC 98-138 at para. 78 (seeking comment on whether 30% remains the appropriate horizontal ownership limit in light of evolving market conditions).

[5] *Attribution NPRM*, FCC 98-112 at para. 12 *et seq.*

[6] As a general matter, Ameritech does not believe that any particular market share, or level of horizontal concentration, is *per se* anticompetitive. Rather, it is what a particular market share allows a given firm to do, in light of economic conditions in the relevant market, that determines whether a specific market share

The existing rules already permit the conglomeration of cable system and programming interests in a manner that allows incumbent cable operators, and in particular large multiple system operators ("MSOs") like TCI, to dominate the multichannel video programming distribution ("MVPD") market in a manner that threatens the ability of new entrants like Ameritech to bring the benefits of robust competition to cable subscribers. Nationally and locally, horizontal concentration and vertical integration are increasing, threatening to retard further the development of MVPD competition. Moreover, vertical integration is ominously extending beyond the traditional realm of video programming to new technologies and other assets that will be essential in the new digital marketplace. Indeed, the largest MSOs, like TCI, Time Warner and others, are extending their influence over ever greater numbers of subscribers (both directly and indirectly through joint ventures and other partnership arrangements), and acquiring cognizable and non-cognizable interests in providers of programming, critical technology and intellectual property. What is more, these large MSOs are using these interests to consolidate their market position and inhibit the growth of nascent competition in the MVPD market.

Specifically, as the attached study by Dr. James N. Dertozous and Dr. Steven S. Wildman makes clear, incumbent cable MSOs like TCI are able to use the economic leverage they derive from their control over a substantial percentage of cable TV

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is likely to facilitate anticompetitive conduct (for example, in markets where barriers to entry are low, even a firm with very high market share may not be able to exercise market power). As discussed below, under prevailing economic conditions in the multichannel video programming distribution ("MVPD") market (in particular, the need for national cable programming networks to reach a critical mass of subscribers in order to be viable), the existing rules already permit large MSOs to exercise monopsony bargaining power to demand preferential or exclusive access to valuable video programming. As a result, competing MVPDs are placed at a cost disadvantage.

subscribers to conclude programming agreements with both affiliated and unaffiliated cable programming networks that disadvantage competitors. This is because, in order to be economically viable, a programmer must reach a critical mass of viewers, which has been estimated to be approximately 20 million subscribers. To reach that number, a programmer must reach agreement with one or more of the largest MSOs. As a result, the large MSO's possess enormous leverage in negotiating the terms of carriage agreements. As such, they are able to demand exclusive carriage arrangements, denying competitors access to cable programming essential to attract subscribers. Alternatively, they can extract preferential rates and terms for carriage that cannot be justified by any cost-savings that might be realized from negotiating with larger MSOs.[7] In either event, established MSOs can effectively retard competitive entry, [8] locking in supracompetitive profits that cannot be competed away.[9] Moreover, because many such agreements are beyond the scope of the existing program access rules, either because they are with

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[7] Because a cable system can receive a cable network signal from a satellite and relay it to its subscribers with a simple flip of a switch, it is clear that the marginal cost to cable networks of physically providing programming to additional cable systems is virtually zero. Likewise, administrative costs, such as the cost of negotiating with cable operators, are relatively small. Accordingly, there is simply no justification for charging new entrants like Ameritech rate differentials that, so far as Ameritech has been able to ascertain, reach as high as 55 percent.

[8] Charging higher prices to, or imposing more onerous conditions on, a new entrant can have essentially the same effect as refusing to deal with a new entrant by raising its costs and denying it comparable access to programming necessary to compete effectively with incumbent cable operators.

[9] While the preferential rates paid by large MSOs may permit them to charge somewhat lower rates to subscribers, it is clear that they do not pass through to subscribers the entire cost savings realized from discounted programming, as one would expect if the savings were cost-justified and if the MSOs were subject to effective competition. *See* James N. Dertouzos and Steven S. Wildman, *Programming Access and Effective Competition in Cable Television*, at 20-21, August 14, 1998 ("Dertouzos and Wildman"), Attachment 2. Moreover, the significantly higher programming rates incurred by competing MVPDs significantly limits their ability to compete on price. Consequently, subscribers are denied the benefits of competition, which would lead to even lower subscriber rates.

unaffiliated cable networks or are for terrestrially-delivered programming, there are few protections against these incumbent strategies.

Any relaxation of the cable television horizontal ownership limits and ownership attribution criteria would only permit incumbent operators to consolidate further their existing market power and exacerbate the problems that confront alternative MVPDs seeking to break into the MVPD market. Accordingly, the Commission should not take any action in either of these proceedings that would increase further horizontal concentration or vertical integration in the cable industry, at least not until Congress or the Commission further strengthens and closes the loop-holes in the program access rules. Specifically, the Commission should not even consider increasing the horizontal ownership limits or relaxing the ownership attribution rules until the program access rules have been extended to encompass terrestrially delivered programming and non-vertically integrated cable programming networks, and modified to ensure that MVPD entrants can procure programming on the same terms as those offered to the incumbent MSOs against which they compete in their own markets. Moreover, the Commission should examine closely the effects of cable horizontal concentration and increasing vertical integration between incumbent cable operators and providers of critical technologies and services on the emerging broadband, digital marketplace before considering whether to modify its horizontal ownership and ownership attribution rules.

II. Large MSOs Already Can and Do Use Their Control Over Access to Subscribers and Vertical Links to Suppliers of Programming and Vital Technology to Limit Competition in the MVPD Market.

Policy makers have long been concerned about the potential anticompetitive effects of horizontal concentration and vertical integration in the cable industry. These concerns are clearly reflected in the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act"),[10] which directs the Commission to establish regulations governing the behavior of vertically integrated cable systems (including the pricing of cable programmers in which cable systems have a significant ownership interest),[11] and limiting the number of subscribers that a person may reach through cable systems that such person owns or in which such person has an attributable interest.[12] Despite these provisions, and the Commission's efforts to promote competition in the MVPD market, the largest MSOs continue to expand horizontally and vertically, consolidating their control over cable subscribers, programming and critical new technologies and services.

Moreover, the Commission's existing regulations do not adequately address the anticompetitive effects of horizontal concentration in the cable industry, and appear to be insufficient to deter anticompetitive conduct by vertically integrated cable systems. In particular, the existing rules do not address the ability of large MSOs to exercise monopsony power to extract exclusive or more favorable programming agreements from

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[10] Pub. L. No. 102-385, 106 Stat. 1460 (1992).

[11] 47 U.S.C. § 548(c).

[12] 47 U.S.C. § 533(f).

unaffiliated cable networks to the disadvantage of rival MVPDs. Nor do they limit the incentive or ability of providers of critical technology and intellectual property that are affiliated with incumbent operators from discriminating against rivals to their downstream cable affiliates.[13] Moreover, the existing program access rules have significant loop-holes that allow vertically integrated programmers to favor their downstream cable affiliates to the detriment of competing MVPDs.[14] As a result, significant structural barriers to competition in the MVPD market remain.

A. The cable industry continues to be highly concentrated; indeed, concentration is increasing.

Despite the Commission's efforts to promote competition in the MVPD market, the cable industry remains highly concentrated, and such concentration appears to be increasing. A little over a decade ago, the five largest MSOs served less than 30 percent of all cable households. Last year, that number had risen to almost 70 percent.[15] Moreover, the increasing incidence of clustering, cable system swaps, mergers,

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[13] As discussed in Ameritech's recent comments in CS Docket 98-102, the largest MSOs are acquiring significant interests in technologies and services that will be critical to cable's commercial success in the newly emerging digital marketplace (these include interests in manufacturers of cable set-top boxes; providers of interactive, electronic program guides; and providers of cable modem Internet access services). *See* Comments of Ameritech New Media, Inc., in *Notice of Inquiry Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, CS Docket No. 98-102, at 42-46, filed July 31, 1998. Ameritech believes that, if incumbent MSOs gain control over these critical technologies, they will effectively act as gatekeepers for competition in the digital marketplace.

[14] For example, a vertically integrated programmer may be able to avoid the program access rules by delivering programming terrestrially, or by structuring their rate cards in a manner that they would argue does not discriminate against unaffiliated cable systems, but which very clearly places new entrants at a substantial cost disadvantage.

[15] *Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, CS Docket No. 97-141, Fourth Annual Report, FCC 97-423 at Table E-3 (January 13, 1998) (*Fourth Annual Report*).

partnerships and other forms of joint ventures, has significantly enhanced the market power of the largest MSOs. This trend is, perhaps, best exemplified by the actions of TCI, the largest MSO in the country, which has extensive, overlapping ownership interests throughout the cable industry. While the number of subscribers reached by cable systems in which TCI has a 100 percent ownership interest seems to have fallen as a result of cable system swaps, mergers, and various joint ventures, the number of subscribers served by cable systems in which TCI has an attributable interest appears actually to have increased to approximately 36 percent.[16] And, as if that were not enough, AT&T Chairman Michael Armstrong, who has already publicly acknowledged that TCI systems pass roughly one-third of American homes, has indicated that AT&T plans to purchase more cable systems or conclude other agreements with cable operators if AT&T's acquisition of TCI is approved, further concentrating the cable industry.[17]

TCI has, for example, virtually tripled the number of subscribers in which it has an attributable interest in the city of Los Angeles through a joint venture with Century.[18] It also has entered into a joint venture with Cablevision in New York, New Jersey and Connecticut, which will increase the number of subscribers in which it has an attributable interest from 850,000 to 3.5 million.[19] TCI has further extended its subscriber reach

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[16] Ted Hearn, *FCC Moving on Cable: Ownership Rules*, MULTICHANNEL NEWS, June 8, 1998, p. 48. Due to the myriad overlapping interests of cable operators in each other's systems, it is difficult to determine precisely how many cable subscribers are attributable to each MSO.

[17] *What Talks? TCI Caps Months of Rumors with AT&T Merger Plan*, CABLEFAX DAILY, June 24, 1998, p.1. Indeed, AT&T has apparently already held discussions with Time Warner concerning some type of affiliation that would allow AT&T to utilize Time Warner's facilities to offer local phone service to subscribers. *AT&T Eyes More Cable Deals*, CABLE WORLD, July 20, 1998, p.30.

[18] John M. Higgins, *TCI Looks to the Rainbow*, BROADCAST AND CABLE, April 20, 1998, p. 14.

[19] *Id.*

through its interest in other MVPDs. In addition, TCI, through TSAT, holds a 36.8 percent interest in PrimeStar, a DBS provider serving over 2 million subscribers,[20] and wholly owns Satellite Services, Inc. ("SSI"), which acquires satellite television programming and distributes it to non-affiliated MVPDs through NetLink U.S.A. d/b/a Netlink International, another wholly-owned subsidiary of TCI. As a result, when TCI sits at the negotiating table, it represents a significant portion of the nation's television viewers, and can obtain virtually whatever terms it wants. The increase in horizontal concentration in the cable industry has, therefore, afforded TCI and other large MSOs monopsony bargaining power, through which they can extract preferential rates and terms, including exclusivity and steep discounts, from even unaffiliated cable networks.[21] Consequently, new entrants like Ameritech are placed at a distinct, competitive disadvantage, undermining the development of robust competition in the MVPD market.

[20] While TCI and its cable partners are negotiating to divest their interest in PrimeStar in response to antitrust concerns raised by the Department of Justice, under the current proposal PrimeStar will remain under the control of John Malone through Liberty Media, and therefore affiliated, albeit indirectly through Malone's interest in AT&T, with TCI. *Murdoch and Malone: Primestar Plan All Part of the Larger Picture*, CABLEFAX DAILY, August 12, 1998, p. 1 (reporting that John Malone, through Liberty and United Video Satellite Group, and Rupert Murdoch, through News Corp., propose to take control of Primestar by buying out its cable partners). As such, it is unlikely that the sale of PrimeStar to Malone and Murdoch, assuming the parties agree to such a transaction and that the transaction is ultimately approved, will alter significantly TCI's or PrimeStar's ability to obtain preferential access to programming.

[21] *See* Program Access Complaint of World Satellite Network, Inc. v. Tele-Communications, Inc., Satellite Services, Inc. and Netlink International, filed July 1, 1998, page 6 (noting that TCI enjoys an enormous cost advantage in purchasing programming because of the number of subscribers it represents, and that TCI uses that advantage to control the delivery of programming to millions of households both within and outside its franchise areas).

B. Cable operators continue to hold significant ownership interests in programming providers.

As the Commission is fully aware, cable operators, and in particular the largest MSOs, continue to hold significant ownership interests in cable programming services. In 1997, 68 (or approximately 40 percent) of the 172 national satellite-delivered cable programming services were vertically integrated with at least one MSO, with cable MSOs owning 50 percent or more of 50 such programming services.[22] Twenty-six of the 50 most subscribed-to cable networks, including 8 of the fifteen top-rated networks, were vertically integrated.[23] These include many of the crown jewels of cable programming, like TCI's Discovery Channel, and Time Warner's CNN, HBO, TBS and TNT, which simply must be included on a system's line up for the system to compete effectively.

Vertical integration continues to involve primarily the largest MSOs. In 1997, the eight largest MSOs had a stake in all of the 68 vertically integrated national cable networks.[24] TCI, through Liberty Media ("Liberty"), a wholly-owned subsidiary of TCI, held ownership interests in 39 of these national programming services, including Discovery, Fox Sports, and BET, or 23% of all national programming networks.[25] According to a more recent industry survey, TCI, through Liberty, holds attributable

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[22] *Fourth Annual Report* at para. 158-59.

[23] *Id.* at 160.

[24] *Id.* at 161.

[25] *Id.* MediaOne, Comcast, Cox and Cablevision Systems also have stakes in numerous cable programming networks.

interests in more than 70 national, regional and international cable programming networks.[26]

Because of the structure of the AT&T/TCI merger, it is not clear that Liberty Media will remain an attributable interest of TCI. Nevertheless, even without such an attributable interest, Liberty Media (which will be majority owned by John Malone) will have a strong incentive to offer preferential rates and terms for programming (or indeed exclusive programming arrangements) to TCI because of Mr. Malone's significant, but possibly unattributable, interest in TCI through his ownership of shares in AT&T following the merger. These exclusive or preferential programming arrangements may escape regulatory scrutiny because of the loophole in the program access rules for unaffiliated programming contracts. In addition, as discussed below, even without vertical ownership ties, TCI can extract more favorable rates and terms for programming from Liberty than can smaller operators, limiting such operators' ability to compete in the MVPD market.

C. Larger and vertically integrated cable operators receive preferential access to cable programming, inhibiting the development of robust competition in the MVPD market.

Cable operators have long enjoyed market power and monopoly profits due to their virtual monopoly in local cable markets. This market power has manifested itself in significant rate increases that far exceed the rate of inflation.[27] It is also vividly

[26] Paul Kagan Associates, *Cable Program Investor*, July 7, 1998.

[27] Between July 1, 1997, and June 30, 1998, cable rates increase 7.3 percent versus 1.7 percent for the Consumer Price Index as a whole. In June alone, cable prices increased seven times faster than the

demonstrated by the fact that incumbent operators have not increased subscriber rates in those few areas in which they confront effective local competition.[28] Incumbent operators, therefore, have a clear and significant incentive to attempt to preserve their monopoly profits by restricting competitive entry.

As might be expected, incumbent cable operators, and large MSOs in particular, have pursued a variety of strategies to retard competitive entry, including inducing program suppliers to limit new entrants' access to programming both through the exercise of monopsony buying power and through vertical links with program suppliers.[29]

i. Large MSOs can use their monopsony bargaining power over unaffiliated program suppliers to disadvantage competitors in the downstream video distribution market.

In addressing the critical, competitive issue of MVPD access to programming, Congress and the Commission have focused largely on the competitive concerns associated with exclusive or discriminatory program licensing agreements between cable networks and affiliated cable systems, virtually ignoring the analogous problems arising from such agreements between large MSOs and non-vertically integrated cable networks. As the attached study by Dr. Dertozous and Dr. Wildman demonstrates, large MSOs have

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underlying rate of inflation. *Cable Rate Figures Provide Fodder for Hearing*, COMMUNICATIONS DAILY, July 15, 1998.

[28] As the attached chart demonstrates, the national trend of significant rate increases has not manifested itself in communities where Ameritech competes as a cable overbuilder. *See* Attachment 1.

[29] Even where there is little question about the applicability of the program access rules, vertically integrated cable networks have continued to flout the rules, forcing competitive MVPDs to expend substantial resources to obtain nondiscriminatory access to cable programming. *See, e.g.*, *Echostar Communications Corporation v. Fox/Liberty Networks, LLC; FX Networks, LLC*, 13 FCC Rcd 7394 (1998); *Corporate Media Partners d/b/a Americast, Ameritech, BellSouth Interactive Media Services, Inc., GTE Media Ventures Incorporated, and SNET Personal Vision, Inc. v. FX Networks, Fox/Liberty Networks, and TCI*, 13 FCC Rcd 8573 (1998).

substantial leverage over unaffiliated cable networks, which they can use to disadvantage competitors, by virtue of their control over access to significant numbers of subscribers. This leverage derives from the peculiar economic conditions in the MVPD market, particularly the significant first-copy program production costs and economies of scale associated with the production and distribution of cable programming, as well as the need for cable networks to reach a critical mass of viewers in order to be commercially successful.

Cable networks, as Professors David Waterman and Andrew Weiss have observed, confront high first-copy production costs to produce cable programming.[30] Once such programming has been created and transmitted to a satellite, however, cable networks realize significant economies of scale in program distribution because the marginal cost of distributing programming to additional cable systems is extremely low – indeed, the marginal cost of distributing cable programming is, as Dertouzos and Wildman observe, essentially zero because a cable network's satellite signal falls automatically on the headend of any cable system located within its broadcast footprint.[31] Because of these conditions, a cable network must on average recover revenues above its marginal sales and distribution costs in order to recover its first-copy production costs.[32]

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[30] David Waterman & Andrew A. Weiss, *Vertical Integration in Cable Television* at 58 (1997) ("Waterman & Weiss").

[31] Dertouzos and Wildman, at 11. *See also* Waterman & Weiss at 60-61 ("The actual extent of scale economies in cable networking is an empirical question about which we do not have systematic data. It is evident, however, that individual cable systems can, with little more than a flip of a switch, take a network signal from a satellite and relay it to subscribers."). Waterman & Weiss further observe that "[o]ther marginal costs to a network, such as negotiations with operators, billing, and the like, are also relatively small." *Id.* at 61.

[32] Waterman & Weiss, at 74.

It has been estimated that, in order to break even, a cable network must reach a critical mass of approximately 20 million subscribers, and, therefore, strike a deal with one or more large MSOs.[33] As a result, a large MSO can force a cable network to provide its programming at a price that is well-below the network's average costs, simply by threatening to deny the network access to its subscriber base,[34] or by threatening other punitive action (such as changing channel position or refusing to promote) against any network that does business with a new entrant. Because competing MVPDs reach far fewer subscribers than large MSOs, they do not have sufficient bargaining power to obtain similar discounts. Moreover, because the large MSOs' preferential access is not cost-justified, competing MVPDs are placed at a cost disadvantage, retarding the development of robust competition in the downstream multichannel video programming distribution market.[35]

As Wildman's and Dertouzos' study clearly establishes, large MSOs can and do utilize their leverage over unaffiliated cable networks to disadvantage new entrants in at

[33] *See Petition for Exclusivity of Outdoor Life Network and Speedvision Network*, CSR-5044-P (filed July 15, 1997).

[34] While possible, it is highly unlikely that a cable network would be able to reach a sufficient number of subscribers to be viable if it were denied carriage by one of the large MSOs, because such a network would have to obtain carriage on virtually all of the other MSOs' and independent MVPDs' systems in order to reach 20 million subscribers. In any event, a failure to obtain carriage on one of the large MSO's cable systems would substantially reduce a cable network's profitability. Thus, a failure to obtain carriage on a large MSO's systems would dramatically reduce the likelihood that a new network could reach a sufficient number of subscribers to be viable, and threaten the ability of even established networks, like CNN, to support high cost services, potentially relegating such networks to niche status.

[35] *See* Waterman & Weiss, at 75 ("an MSO can become a free rider on the contributions of other cable systems to the first-copy costs of production. The essence of the free-rider problem is that a price-making MSO ignores an externality effect that its localized exercise of monopsony power imposes on other cable operators, whose profits will fall with the decline in attractiveness of programming they can offer to consumers.").

least two ways.[36] First, Dertouzos and Wildman show that incumbents and operators with large subscriber bases can always outbid new entrants for exclusive geographic rights to attractive programming.[37] The empirical record amply supports Dertouzos' and Wildman's analysis and predictions. News Corp., the parent company of Fox, has, for example, admitted that in order to secure cable carriage for FX in 1994, it granted exclusive distribution rights to incumbent cable operators.[38] Similarly, NBC and CBS have declined to provide Ameritech and other new entrants access to their cable programming, MSNBC and Eye on People, because of exclusive distribution arrangements with incumbent operators. Moreover, Viacom, which is no longer vertically integrated with cable operators, has denied Ameritech access to TV Land, which is growing in popularity, and has compounded the damage resulting from this denial by aggressively promoting TV Land on Nickelodeon, a cable network Ameritech does carry.[39] More recently, Classic Sports Network ("CSN"), which had been carried by

[36] *See* Dertouzos and Wildman, at 1 (the "problems cable entrants encounter in their attempts to acquire programming severely limit their ability to effectively compete with large incumbent [MSOs] for two reasons: (1) Entrants must pay much higher prices for the networks they package and deliver to subscribers than do the large incumbent MSOs with whom they compete; and (2) Large incumbents can and do find it profitable to deny entrants access to certain types of popular networks by either licensing them exclusively for their own use or by purchasing them and refusing to license them to competitors").

[37] *Id.* at 26 (noting that "there are strong theoretical reasons to expect that, due to their large subscriber bases and extensive geographic reach, incumbent MSOs will systematically find it profitable to outbid entrants for exclusive rights to popular networks . . . . Once acquired, networks over which they have exclusive rights can be bundled with networks they offer in common with entrants and priced so that entrants will not be able to compete."); and at 27 ("MSOs serving both competitive and noncompetitive franchise areas will always find it profitable to outbid entrants for exclusive rights to networks."). *See also id.* at 28-31 (demonstrating why MSOs find it profitable to obtain exclusive access to programming).

[38] Consolidated Supplemental Reply of the News Corporation Limited, In re Application of MCI Telecommunications Corporation and Primestar LHC, Inc., FCC File No. 106-SAT-AL-97, Feb. 20, 1998 at 5.

[39] Ameritech notes that, because Viacom has spun off its cable systems, other, more popular Viacom programming, like MTV and Nickelodeon, could become subject to exclusive contracts. Similarly, if Liberty Media is no longer affiliated with TCI, it could grant exclusive access to a vast array of popular

Ameritech on a non-exclusive basis since Ameritech initiated its cable operations, entered an exclusive carriage agreement with, *inter alia*, MediaOne, which would, if permitted, force Ameritech to drop CSN from its line-up beginning January 1, 1999.[40]

Even vertically-integrated programmers have attested to the prevalence of exclusive distribution arrangements between non-vertically integrated programmers and incumbent operators. In petitioning for the right to enter exclusive distribution agreements, Outdoor Life Network and Speedvision (which are owned in part by Cox, Comcast and MediaOne) argued that they were at a distinct competitive disadvantage because they could not grant exclusive distribution rights to incumbent cable operators – "Time and time again, cable operators who were ready to affiliate with the networks, or to substantially increase the number of systems on which they carry the networks have chosen instead to carry other, often lesser quality networks that they were able to provide exclusively."[41]

Some incumbent cable operators have, nonetheless, argued that exclusivity is procompetitive, and necessary to encourage investment in new programming.[42] This

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cable programming. Moreover, as Ameritech's experience with Classic Sports Network (discussed below) demonstrates, it is not at all unlikely that Viacom or Liberty Media might enter exclusive arrangements with incumbent MSOs, requiring new entrants like Ameritech to drop popular programming that they already carry from their channel line-ups.

[40] Ameritech has filed a Program Access Complaint against MediaOne to prevent it from enforcing the exclusivity provisions of its carriage agreement with CSN. *Ameritech New Media, Inc. v. MediaOne and Time Warner* (filed July 1, 1998).

[41] Petition of Outdoor Life Network and Speedvision Network for Exclusivity, filed July 15, 1998, at 23. The Commission recently denied Outdoor Life Network's and Speedvision Network's petition. *Petition for Exclusivity of Outdoor Life Network and Speedvision Network*, Memorandum Opinion and Order, CSR-5044-P, DA 98-1241 (June 26, 1998).

[42] *See, e.g.* Testimony of Leo J. Hindery, Jr., President Tele-Communications, Inc., Before the Senate Committee on Commerce, Science, and Transportation, July 28, 1998, at 28-29.

claim, however, is wholly without foundation, and belied by Ameritech's experience with CSN. In the CSN case, Ameritech carried CSN's programming on a non-exclusive basis for several years, helping to establish the popularity of that network, before incumbent cable operators came along and negotiated exclusive arrangements with CSN which could, potentially, deprive Ameritech of popular programming it is already carrying.

Some have also suggested that exclusive program distribution agreements involving non-vertically integrated programmers may promote the development of competitive cable markets.[43] As Dertouzos and Wildman point out, however, "there is little empirical evidence that exclusive arrangements with networks have facilitated competitive entry."[44] Accordingly, there appears to be little, if any, justification for exclusive programming distribution arrangements, even between unaffiliated entities, at least under existing market conditions.

It is, therefore, clear that incumbent MSOs can, and have, used their control over large numbers of subscribers to outbid new entrants for exclusive rights to distribute attractive programming. As a result, new entrants are placed at a permanent programming quality disadvantage, and often unable to compete effectively in the MVPD market.[45]

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[43] *See* Petition for Exclusivity of Outdoor Life Network and Speedvision Network at 33.

[44] Dertouzos and Wildman at 25 (noting that, "exclusive arrangements with networks seem to have been employed primarily by incumbent operators, not the entrants contesting their markets").

[45] *Id.* at 28 (observing that, so long as incumbents can obtain exclusive licenses, "the entrant [would always be] left in the position of selling a less appealing set of networks than the incumbent, and therefore not able to constrain the incumbent's prices and profits to the extent we normally would expect and hope for in a competitive market."), and 31 ("allowing incumbents and entrants to compete for exclusive programming rights may make it possible for an incumbent cable operator to perpetuate its dominant position indefinitely by buying exclusive rights to popular programming").

Second, large MSOs can use their monopsony bargaining power to demand significant price discounts, forcing new entrants to pay substantially higher prices than their incumbent competitors for programming they need to compete.[46] In their report, Dertouzos and Wildman undertake an extensive examination of the prices cable networks charge to cable operators based on data from two sources.[47] The data from both sources showed that large, incumbent MSOs are able to license cable network programming at considerably lower rates than smaller cable operators and other MVPDs, including, in particular, their direct competitors in local markets.[48]

Wildman's and Dertouzos's findings are borne out by Ameritech's experience. Although it is difficult to ascertain the full extent of price discrimination in the video programming market because of the secrecy surrounding cable networks' programming pricing,[49] in those instances where information is available, rate differentials of 40 percent or more are not uncommon. Dertouzos' and Wildman's analysis of industry financial data suggests that the actual off-rate-card discounts provided to large MSOs may

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[46] *Id.* at 2 ("Cable entrants' price disadvantage on independently supplied networks is a consequence of the frequently dramatic discounts the largest MSOs are able to negotiate with network suppliers compared to the prices paid by entrants and small MVPDs generally."). Dertourzos and Wildman observe that the ability of large MSOs "to negotiate dramatically lower network supply prices is due almost entirely to the tremendous bargaining leverage they realize from their control over access to many millions of cable viewers." *Id.*

[47] Dertouzos and Wildman first examined rate cards for six networks to determine whether cable networks charge new entrants more for programming than incumbents, and, if so, by how much. Next, they examined annual cable network financial data reported by Paul Kagan Associates to verify the results of their analysis of cable network rate cards. *Id.* at 4-25.

[48] *Id.* at page 3-5.

[49] Even where rate cards are made available, the full extent of price discrimination is unclear because, as Dertouzos and Wildman note, the largest MSOs are generally believed to be able to negotiate rates substantially below those reported on rate cards. *Id.* at 7

be much larger than those indicated by publicly available rate information.[50] Moreover, in addition to cash discounts, large MSOs have negotiated carriage agreements that provide them additional non-cash discounts or other incentives, such as marketing support, which are not made available to smaller MVPDs. Because the amount of these discounts is directly tied to the number of subscribers served, only the largest MSOs qualify for substantial discounts.

These price differentials cannot be justified by cost savings realized by networks in negotiating with, and supplying programming to, larger customers. As Dertouzos and Wildman aptly observe, the cost advantages, if any, in supplying programming to large MSOs must be due either to differences in the costs of delivering programming to large and small MVPDs or to lower transaction costs from negotiating with a single buyer representing many subscribers rather than several or many buyers representing the same number of subscribers.[51] The cost of delivering programming is, however, the same for both large and small MVPDs because a cable network's satellite signal covers all cable headends within its broadcast footprint.[52] In addition, Wildman's and Dertouzos' study shows that negotiation cost savings simply cannot account for more than a minute fraction of the differences in network license fees paid by cable entrants and large MSOs.[53] Dertouzos and Wildman, therefore, conclude that "the only plausible explanation for the dramatically lower prices paid by large MSOs is the leverage

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[50] *Id.*

[51] *Id.* at 10-11.

[52] *Id.* at 11, Waterman & Weiss at 58.

[53] Dertouzos and Wildman, at 11-18.

associated with control over very large blocks of multichannel video subscribers."[54] They further conclude that the steep discounts demanded by large MSOs, which cannot be justified by lower costs, impose a significant cost disadvantage on new entrants and limit their ability to compete on price.[55] As a result, incumbents MSOs can use their leverage over cable networks to maintain their monopoly profits. Thus, it is clear that large, incumbent MSOs have the incentive and ability to use their control over access to large numbers of subscribers to foreclose new entrants' access to quality programming they need to compete, and therefore to stifle nascent MVPD competition.

ii. Vertically integrated MSOs can limit MVPD competition by denying competitors nondiscriminatory access to critical programming.

Vertically integrated incumbent MSOs also can and do attempt to limit competition in the MVPD market by limiting alternative MVPDs' access to quality video programming. Absent effective regulation, vertically integrated programmers have the incentive and ability to favor their downstream cable affiliates by denying unaffiliated MVPDs access to popular programming or supplying access only at discriminatorily high prices. In so doing, a vertically integrated MSO can raise its rivals' costs, allowing it to charge supracompetitive prices and thus maintain its monopoly profits.

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[54] *Id.* at 18.

[55] As previously noted, charging high prices to a new entrant can have the same competitive effect as an exclusive contract. *See* Waterman & Weiss at 133; Dertouzos and Wildman at 10 ("To the extent that these large price differences are not based on true cost differences or legitimate business incentives, they are discriminatory and a barrier to competition.").

Although the program access rules are intended to forestall such anticompetitive conduct, the existing rules do not go far enough to prevent vertically integrated MSOs from effectively disadvantaging their MVPD rivals. For example, such MSOs may be able to avoid the strictures of the program access rules simply by delivering programming terrestrially rather than via satellite. This is because section 628 of the Communications Act generally does not apply to non-satellite delivered cable programming.[56] As fiber optic technology improves and costs continue to drop, vertically integrated programmers will find it increasingly efficient to deliver their programming terrestrially and thereby circumvent the requirements of section 628. Moreover, large MSOs have significantly enhanced their ability to deliver cable programming terrestrially through their acquisition of interests in and alliances with competitive local exchange carriers,[57] which furnish them access to fiber optic transmission facilities. The increasing incidence of clustering further increases the likelihood that vertically integrated MSOs will exploit this loophole in the program access rules by substantially lowering the costs of terrestrial delivery of cable programming.

The threat that vertically integrated cable networks will avoid the program access requirements through terrestrial delivery is no mere possibility. Rainbow MediaHoldings, Inc. recently announced plans to distribute cable-exclusive "hyperlocal" regional channels

[56] 47 U.S.C. § 548.

[57] For example, Comcast has an interest in Eastern TeleLogic; Time Warner has initiated local exchange service through Time Warner Access; and Cablevision proposes to offer local exchange services through Cablevision Lightpath. Additionally, TCI has an affiliation in Teleport Communications Group that will be strengthened if the proposed merger between TCI and AT&T is consummated.

via fiber in the tri-state area of New York, Connecticut, and New Jersey.[58] Similarly, Comcast SportsNet, a regional sports network affiliated with Comcast, has shifted from satellite to non-satellite transmission methods to deliver regional sports programming in Phildelphia, and has denied DirecTV and Echostar access to its programming on that basis.[59] Thus, vertically integrated cable networks can, and do, easily exploit the glaring gap in the program access rules for terrestrially delivered programming to avoid their non-discrimination obligations and undermine the ability of unaffiliated cable operators to compete with their downstream cable affiliates.[60]

Alternatively, a programmer that is affiliated with a large MSO can structure its rate card to put new entrants at a substantial cost disadvantage relative to incumbent operators. For example, a vertically integrated cable network could (and many do) structure its rate card so that only large MSOs can obtain the benefits of volume discounts, such as by charging an undiscounted rate to cable operators with less than a certain number of subscribers, and providing volume discounts that increase with the number of subscribers served. Because such discounts are not cost-justified, they are

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[58] R. Thomas Umstead and Jim Forkan, *Rainbow Keeps New Services Exclusive*, MULTICHANNEL NEWs, July 6, 1998, p. 83.

[59] Program Access Complaints filed in *DirecTV, Inc. v. Comcast Corporation*, FCC Docket No.CSR-5112-P at 3; and *Echostar Communications Corp. v. Comcast Corporation, Comcast-Spectator, L.P., Philadelphia Sports Media, L.P.* , FCC Docket No. CSR-5244-P.

[60] Ameritech applauds the Commission's recent order strengthening its program access rules by, *inter alia*, adopting time limits for the resolution of program access complaints, affirming Commission authority to impose damages for program access violations, and requiring a defendant to attach to its answer any document within its control on which it relies in defending a program access claim. *Implementation of the Cable Television Consumer Protection and Competition Act of 1992; Petition for Rulemaking of Ameritech New Media, Inc. Regarding Development of Competition and Diversity in Video Programming Distribution Carriage*, Report and Order, CS Docket No. 97-248, RM No. 9097, FCC 98-189 (Adopted Aug. 6, 1998). Despite these actions, however, significant gaps in the program access rules relating to the terrestrial delivery of programming and the application of the rules to non-vertically integrated cable networks remain.

discriminatory[61] and place new entrants at a significant programming cost disadvantage, undermining their ability to compete effectively with such a network's downstream cable affiliate.

Even if the Commission could effectively police all transactions between incumbent operators and their affiliates, a vertically integrated cable network could still limit competition in the downstream video distribution market by engaging in a price squeeze. A vertically integrated cable network could, for example, increase its rates to all cable systems and other MVPDs, including its downstream affiliate. While such an increase would nominally increase the downstream affiliate's costs, in reality the increase would simply effect a transfer of revenue from one pocket of the integrated firm to another.[62] For competing MVPDs, however, such an increase would be a real increase in operating expenditures, forcing them to raise their rates to reflect their increased costs or to attempt to maintain market share by not raising rates, and thereby reducing their

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Ameritech therefore urges the Commission to close these gaps, or to request Congress to amend section 628 to apply also to terrestrially delivered programming and non-vertically integrated cable networks.

[61] Some may argue that such discounts are not discriminatory because the rates and terms offered to a MSO competitor by a vertically integrated cable network are comparable to those offered to a comparably sized MVPD. This is an incorrect comparison. The rates charged to the new entrant should be compared to those offered to the network's downstream MSO affiliate. Comparing the rates and terms offered to a MSO competitor to those offered to a comparably-sized MVPD, rather than to those offered to the network's downstream MSO affiliate, incorrectly assumes that the differences in the rates and terms offered to MSOs and smaller MVPDs are cost-justified. Moreover, such a comparison builds into the price competitors pay the cost implications of the bargaining disadvantage of smaller MVPDs generally.

[62] *Cable's hold on America*, THE ECONOMIST, January 24, 1998, p61-62 ("Certainly, the cost of television programming has rocketed, with stars from such programmes as "Seinfeld" charging huge fees. But since TCI and Time Warner, the two biggest cable companies, make 23% and 12% of cable programming respectively, their plea [that higher cable rates are due to higher programming costs] sounds self-serving. Indeed, the regulators worry that programme-making cable companies, which are obliged to make their programming available to their competitors, are loading system costs on to their producers arms, thereby passing them on to satellite broadcasters and other cable operators. The price of programming made by the cable companies rose by 16% last year, whereas the price of programmes made by the broadcasters rose by only 4%.").